

HOUSE BUDGET COMMITTEE

Democratic Caucus

The Honorable John M. Spratt Jr. ■ Ranking Democratic Member

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February 12, 2003

Weak Economy Already Falling Short of Budget's Rosy Economic Assumptions

Dear Democratic Colleague,

The budget's return to chronic deficits makes it more important than ever to understand the economic assumptions that underlie the Administration's latest supply-side gamble. The economy's continuing stagnation is calling into question the Administration's already exuberant growth predictions. And, it appears even less likely that economic performance will *surpass* that assumed in the President's budget — and lead a return to budget surpluses, as the Administration claims.

The Administration Again Promises Better Growth

Four times before — in the fiscal year 2002 *Budget*, the fiscal year 2002 *Mid-Session Review*, the fiscal year 2003 *Budget*, and the fiscal year 2003 *Mid-Session Review* — the Administration assured us that its policies would produce faster economic growth, and that its budget estimates were cautious. Now, the Administration's responds to criticism about widening budget deficits by holding out false hope that the economy will perform better than its own already robust predictions.

It is difficult to find these budget and economic promises credible, because the economic assumptions in the President's budget are optimistic from top to bottom — and still produce chronic budget deficits. The following table shows that the Administration's assumptions for the most part are more favorable than those of the Congressional Budget Office (CBO) and the Blue Chip consensus of private-sector economists.

Higher projections of real economic growth produce more favorable budget outcomes, while lower projections for consumer price inflation, unemployment, and interest rates improve budget forecasts. For every one of these indicators, for every single year, the Administration's projection is more favorable than, or equal to, the CBO assumption or the Blue Chip consensus.

Comparison of Economic Assumptions Calendar Years						
	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>
Real GDP Growth 1/						
CBO January	2.5	3.6	3.4	3.3	3.2	3.1
Blue Chip Consensus January 2/	2.8	3.6	3.3	3.1	3.1	3.1
2004 Bush Budget	2.9	3.6	3.5	3.3	3.2	3.1
Consumer Price Index 1/						
CBO January	2.3	2.2	2.4	2.5	2.5	2.5
Blue Chip Consensus January 2/	2.2	2.2	2.5	2.6	2.5	2.5
2004 Bush Budget	2.2	2.1	2.1	2.2	2.2	2.3
Unemployment Rate 3/						
CBO January	5.9	5.7	5.4	5.3	5.2	5.2
Blue Chip Consensus January 2/	5.9	5.5	5.1	5.1	5.1	5.1
2004 Bush Budget	5.7	5.5	5.2	5.1	5.1	5.1
91-Day Treasury Bill Interest Rate 3/						
CBO January	1.4	3.5	4.8	4.9	4.9	4.9
Blue Chip Consensus January 2/	1.6	2.9	4.2	4.4	4.6	4.4
2004 Bush Budget	1.6	3.3	4.0	4.2	4.2	4.3
10-Year Treasury Note Interest Rate 3/						
CBO January	4.4	5.2	5.7	5.8	5.8	5.8
Blue Chip Consensus January 2/	4.4	5.2	5.6	5.8	5.7	5.7
2004 Bush Budget	4.2	5.0	5.3	5.4	5.5	5.6
1/ Year over year percent change.						
2/ Blue Chip January 2003 consensus for 2003-2004; October 2002 long-run for 2005-2008.						
3/ Annual averages, percent.						
Source: <i>Fiscal Year 2004 Budget of the U.S. Government</i> , p. 329, table S-12.						

Why Are the Administration's Deficits in 2003 and 2004 Worse Than CBO's?

In 2003 and 2004, the Administration's baseline deficit projection is worse than CBO's. How can that be true, when OMB's economic assumptions are more favorable? The answer lies in the less widely understood technical assumptions, discussed below.

On page 30 of the *Analytical Perspectives* volume of the budget package, the Administration shows its so-called technical re-estimates to the President's budget totals. These technical factors are largely judgmental changes to projected deficits that reflect the Administration's view that the economic models by themselves will give misleading predictions. The most important of these judgmental changes concerns the amount of revenues produced by any given level of GDP. The Administration has made substantial downward technical adjustments to projected revenue — but only in 2003 and 2004.

Technical Re-Estimates of Revenues Billions of Dollars						
	2003	2004	2005	2006	2007	2008
Receipts	-134	-77	-42	-11	-*	1
* Less than \$500 million						
Source: <i>Fiscal Year 2004, Analytical Perspectives, Budget of the U.S. Government</i> , p. 30, table 2-4.						

The Administration's \$134 billion downward technical adjustment for 2003 is consistent with the very disappointing inflow of revenues thus far in the fiscal year. However, the Administration is betting that this weakness in revenues relative to GDP will be short-lived. By 2005, it is quite small, and it is gone entirely by 2007. Without these large downward technical revisions in 2003 and 2004 and their subsequent fading thereafter, the projected deficit would appear to deteriorate over the next few years, rather than improve as the Administration projects.

The Administration assumes that the current weakness in revenues is purely temporary and that revenues snap back in just a few years. We will not know whether the Administration's bet is correct until well into 2005 — by which time we will have squandered some of the precious time remaining before the retirement of the baby boom begins in 2008.

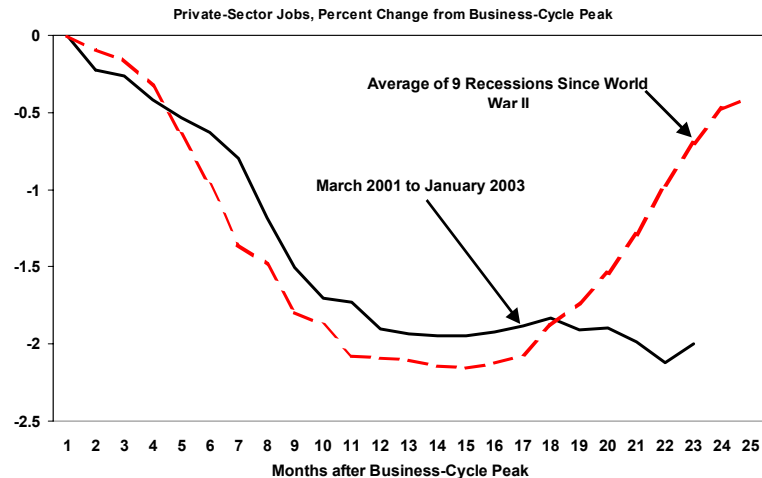
Current Economic Weakness Casts Doubt on Administration's Growth Predictions

In order for the Administration's economic forecast to come true, average real GDP growth will have to be 3.4 percent over the next four quarters and even faster in the four quarters thereafter. If the economy stumbles in one quarter, the lack of growth will have to be made up in some other quarter in order to hit the 3.4 percent average assumed by the President's budget. Economic indicators suggest that the current quarter is off to a bad start, and weak performance now may require faster growth later for the Administration's predictions to come true.

The labor market continues to be very weak. As of January, job growth appears flat at best. The chart below shows that employment has failed to recover from its recession trough. The January job count rebounded by about the same amount it fell the month before. However, the Commissioner of the Bureau of Labor Statistics, Kathleen Utgoff, testified that both the December drop and the January rebound were primarily driven by unusual movements in seasonal hiring, rather than underlying economic trends. Weekly data for new claims for unemployment insurance have continued to fluctuate around 400,000 claims per week, as they

have since the beginning of 2001, suggesting that new job opportunities remain scarce.

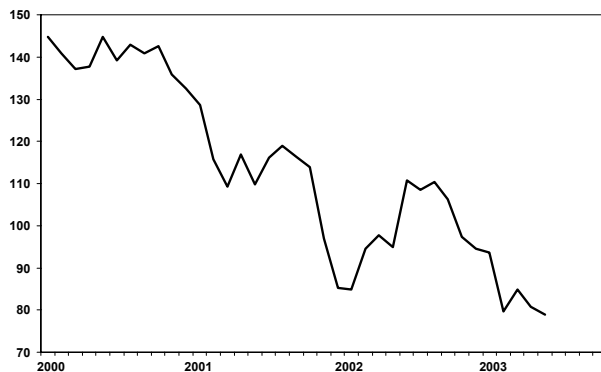
The Jobs Recession



Current indicators of consumer and business demand also show weakness in the most recent data. The Conference Board's Consumer Confidence Index dropped in January to its lowest level in more than eight years. Manufacturers' new orders have been essentially flat since early 2001. Capacity utilization remains at recession levels, suggesting that firms will have little incentive to invest in new plant and equipment until existing capacity is fully employed. While housing activity remains at a high level due to currently low interest rates, non-residential construction has fallen over the last year.

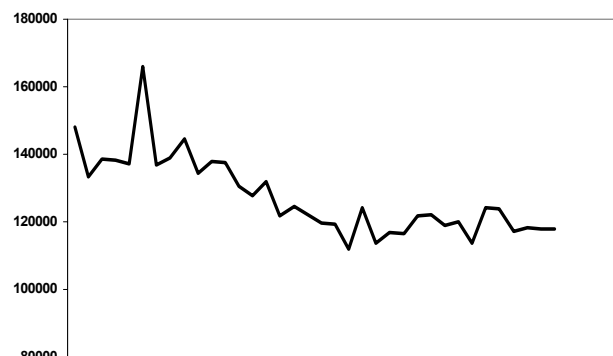
Consumer Confidence

Index, Conference Board



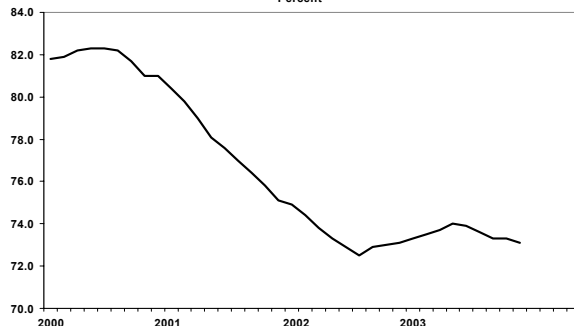
Manufacturers' New Orders

Millions of Dollars per Month



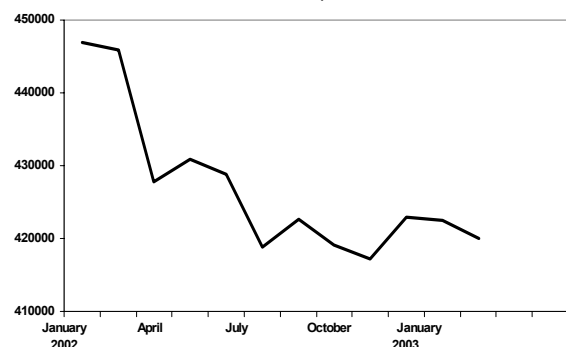
Capacity Utilization in Manufacturing

Percent



Non-Residential Construction

Millions of Dollars per Month



It is hard to see how real GDP growth over the next four quarters can average 3.4 percent per year when current quarter growth will clearly fall well short of that. The respected forecasting firm, Macroeconomic Analysts Inc., currently predicts first-quarter growth at only 1.7 percent. If that happens, then real GDP growth will have to average 4.7 percent over the three quarters thereafter to hit the Administration's 2003 growth target.

Even if growth does rapidly surge like this in the latter part of 2003, it strains credulity to believe that real GDP will then continue strong growth next year at the 3.6 percent pace the Administration assumes. Thus, it will require exceptional economic performance just to achieve the Administration's rosy outlook for the next two years — and even with such performance the budget will remain mired in deficit for the foreseeable future.

Sincerely,

John M. Spratt, Jr.
Ranking Member